

The Honorable Thomas S. Zilly

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

AMERICAN MANAGEMENT SERVICES
EAST, LLC, a Washington limited liability
company, et al.

Plaintiffs,

vs.

SCOTTSDALE INSURANCE CO., a Delaware
corporation, et al.,

Defendants.

CASE NO. 2:15-cv-01004-TSZ

REPLY IN SUPPORT OF PLAINTIFFS'
MOTION FOR RECONSIDERATION

(ORAL ARGUMENT REQUESTED)

NOTE ON MOTION CALENDAR:
JUNE 3, 2016

REPLY IN SUPPORT OF PLAINTIFFS' MOTION
FOR RECONSIDERATION
Case Number: 2:15-CV-1004-TSZ

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1 The issues have been narrowed to whether Defendants breached their duty to defend
 2 Plaintiffs against the claims for Breach of Fiduciary and Aiding and Abetting Breach of
 3 Fiduciary Duty in the Georgia and California Lawsuits. Plaintiffs submit their motion for
 4 reconsideration and should be granted for the following reasons.

5 1) Plaintiffs John Goodman, Goodman Real Estate (fka Goodman Financial Services),
 6 GFS Risk, LLC, Pinnacle Irwin and Pinnacle Monterey should have been defended because it is
 7 not legally or factually disputed that (a) the Project employees involved in the work order
 8 manipulation were not employees or agents of any of these Insureds; and (b) the work order
 9 manipulation was an “occurrence” because the Separation of Insureds language in the Policies,
 10 as interpreted under Washington law, require a separate analysis of coverage for each Insured.
 11 There is no factual or legal basis to extend liability for the employees’ intentional acts beyond
 12 their employers. And there are allegations in the Clark Litigation of negligent and reckless
 13 conduct in regard to the Plaintiffs’ alleged failure to supervise the Project employees.

14 2) Plaintiffs AMS, AMS East, AMS California, and Stanley Harrelson should have been
 15 defended because there are allegations in the Clark Litigation of negligent and reckless conduct
 16 in regard to the Plaintiffs’ alleged failure to supervise the Project employees.

17 3) The Policies are triggered by the possibility of liability arising from “bodily injury” or
 18 “property damage.” However, the indemnity for that liability includes all damages “because of”
 19 the bodily injury or property damage. The Amended Complaints incorporate affidavits of
 20 Project employees, which include allegations of mold, are sufficient to trigger the duty to defend.
 21 If those allegations were proven at trial, the Insurers would be obligated to indemnify the
 22 Insureds for “all sums” the Insureds became legally obligated to pay because of that property
 23 damage.

24 4) Alternatively, extrinsic evidence, presented by Plaintiffs during the claim process and
 25 in its Motion on the Duty to Defend, establishes a duty to defend.

1 5) Plaintiffs are not relying on “new arguments” in support of the motion. They did
 2 advocate for a global finding of coverage on summary judgment, but that does not mean these
 3 arguments are new. Plaintiffs have consistently pointed out that a separate analysis for each
 4 Insured is appropriate. They pointed it out prior to this lawsuit,¹ in the complaint filed in this
 5 lawsuit,² and in the summary judgment briefing.³ This position is not new.

6 ARGUMENT

7 The summary judgment ruling was in manifest error because (1) the objective
 8 determination of “occurrence” resulted in nothing less than a forfeiture of coverage for Plaintiffs
 9 who were undisputably not vicariously liable as “employers” or “principals” of the employees
 10 that are alleged to have committed the work order manipulation, which is in contravention of the
 11 Policies’ assurance of Separation of the Insureds and Washington law recognizing this
 12 distinction; and (2) the Amended Complaints did contain allegations of negligent and reckless
 13 conduct related to the failure of all Plaintiffs to supervise the Project employees, triggering a
 14 defense as for the reasons described in *Pac. Ins. Co. v. Catholic Bishop of Spokane*⁴ and *Liberty*
 15 *Univ., Inc. v. Citizens Ins. Co. of Am*⁵ cases. When the allegations are closely analyzed, they
 16 support a finding of coverage even when an objective standard is applied.⁶

17 In the California lawsuit, Pinnacle (defined to include AMS and AMSC)⁷ was alleged to
 18 have participated in the work order manipulation through its employees at Fort Irwin and
 19

20 ¹ Docket No. 52-10 (Ex. 61) at p. 6 (informing Scottsdale it was improperly using a “one size fits all” theory to
 21 assess coverage and that “[e]ach insured’s request for coverage should be considered independently of the others.”)

22 ² Docket No. 1 at p. 6, ¶ 4.4 (expressly setting forth plaintiffs’ request for a declaration that the insurers “owe
 each Plaintiff a separate and distinct duty to defend”).

23 ³ Docket No. 74 at 27 (noting that an insured-by-insured analysis whether the “owned/controlled property
 exclusion” applied) (quoting *Pac. Ins. Co. v. Catholic Archbishop of Spokane*, 450 F.Supp.2d 1186, 1199 (E.D.
 24 Wash. 2006) and *Unigard Mut. Ins. Co. v. Spokane Sch. Dist. No. 81*, 20 Wash. App. 261, 265-66 (1978)).

25 ⁴ 450 F.Supp.2d 1186 (E.D. Wash. 2006)

⁵ 792 F.3d 520 (4th Cir. 2015).

⁶ Plaintiffs continue to assert that a subjective standard is appropriate in this case, but does not address that issue
 in detail here given the extensive briefing that has already been submitted on the issue.

⁷ Docket 51-10 (Ex. 21) at p. 2.

1 Monterey Bay.⁸ But the Goodman Entities (GRE and GFS) were never specifically alleged to
 2 have participated in the work order manipulation.⁹ The Breach of Fiduciary Duty claims were
 3 alleged against AMS, AMSC, Goodman and Harrelson (the latter, as executive officers).¹⁰ The
 4 claim for aiding and abetting the Breach of Fiduciary Duty included the Goodman Entities, based
 5 on the allegation of their “failing to disclose the insurance fraud, work order frauds, vendor
 6 payments to Pinnacle employees and other misconduct to Plaintiffs, and by concealing these
 7 frauds and other misconduct from Plaintiffs.”¹¹

8 In Georgia, the allegations mirrored those in California, implicating the on-site employees
 9 of AMSE and AMS.¹² The Goodman Entities were alleged to have aided and abetted the other
 10 named parties in perpetrating the alleged work order manipulation.¹³ These allegations described
 11 negligent or reckless conduct as the Goodman Entities were alleged to have “failed to properly
 12 investigate and report” and engaged in “tortious and wrongful conduct.”¹⁴ These “less-than-
 13 intentional” allegations are found elsewhere in describing the Goodman Entities’ liability for
 14 “failure to implement proper financial and other controls to prevent and detect fraud” and
 15 because “at the very least, [they] recklessly tolerated such misconduct.”¹⁵ These allegations
 16 support the law on the duty to defend described by the Supreme Court in *Expedia* and *Woo*
 17 because it was at least “conceivable” one of the insured Plaintiffs could be held liable for
 18 damages as a result of negligent or reckless conduct.

21 ⁸ See generally Docket No. 51-10 (Ex. 21) at pp. 17-23, ¶¶ 64-87 (detailing affirmative allegations of work
 22 order fraud against Pinnacle and not referencing the Goodman Entities).

23 ⁹ See footnote 3, *supra*.

24 ¹⁰ Docket No. 51-10 (Ex. 21) at p. 45, ¶ 190.

25 ¹¹ Id. at p. 47, ¶ 200.

¹² See Docket No. 51-5 (Ex. 16) at ¶¶ 3, 6, 64-87 (alleging work order fraud by on-site employees of AMS and
 AMSE, not against the Goodman Entities).

¹³ Docket No. 51-5 (Ex. 16) at p. 68-69, ¶¶ 199-203.

¹⁴ Id. at ¶¶ 201-202.

¹⁵ Id. at ¶ 102, 247.

1 The work order manipulation was allegedly done by on-site employees.¹⁶ The Goodman
 2 Entities, Pinnacle Irwin and Pinnacle Monterey were not employers or principals of the
 3 offending employees. These critical facts are undisputed. Aside from the aiding and abetting
 4 allegations concerning non-disclosure, allegations of direct participation in the work order
 5 manipulation by the Goodman Entities, Pinnacle Irwin and Pinnacle Monterey, are absent. In
 6 fact, the Georgia Court of Appeals sustained the dismissal of Goodman, Harelson and GRE on
 7 lack of personal jurisdiction ground because there was no evidence that the parties that allegedly
 8 committed work order fraud acted as agents for Goodman, Harrelson, or GRE.¹⁷

9 The analysis of “occurrence” and intentional act exclusions by the Fourth Circuit in
 10 *Liberty Univ.*¹⁸ is helpful. The Court was reviewing a decision on the duty to defend arising in a
 11 case where the underlying Plaintiffs asserted intentional acts by employees and resultant
 12 employer liability. The Circuit Court reversed the District Court concluding there was no duty to
 13 defend. The Court relied on the employer/employee relationship, which resulted in respondeat
 14 superior/vicarious liability.¹⁹ The Court reasoned that an agency relationship or an employment
 15 relationship precluded the employer from obtaining coverage, even if it denied a subjective
 16 expectation of injury or damage. It analyzed the Separation of Insured provision in that context.
 17 The Court’s reasoning precludes imputation of the Pinnacle employees’ misconduct to the
 18 Goodman Entities, Pinnacle Irwin and Pinnacle Monterey. The *Liberty Univ.* court recognized
 19 another exception to the imputed wrongful conduct, allowing even employers and principals to
 20
 21

22 ¹⁶ Docket No. 51-5 (Ex. 16) at 9, ¶ 22 (alleging fraud perpetrated by on-site employees); ECF 51-10 (Ex. 21) at
 23 p. 45, ¶ 190 (alleging the on-site employees of AMSC and AMS committed work order fraud).

¹⁷ Docket No. 94 at Exs. 1-2.

24 ¹⁸ 792 F.3d 520 (4th Cir. 2015); *see also Corp. of the Catholic Archbishop of Seattle v. Arrowood Indem. Co.*,
 25 Case No. C15-175 MJP, 2015 WL 8212719 (W.D. Wash. Dec. 8, 2015) (holding no duty to defend where a party is
 directly alleged to have been vicariously liable, but acknowledging that coverage may be available where the party
 is alleged to have engaged in separate negligent conduct).

¹⁹ *Id.* at 531-32.

1 be defended where there are allegations—and not necessarily express claims—of negligent
2 supervision of the employees.²⁰

3 This case is also analogous to the factual scenario addressed in *Catholic Bishop of*
4 *Spokane*, which was cited favorably in *Liberty Univ.*²¹ Although the *Catholic Bishop* case
5 concerned an express claim for negligent supervision, a specific claim is not necessarily required
6 to trigger coverage. Rather, there is a duty to defend “if the insurance policy conceivably covers
7 the *allegations* in the complaint.”²² As detailed above, the allegations against the Goodman
8 Entities, Pinnacle Irwin, and Pinnacle Monterey all concern negligent supervision in relation to
9 work order manipulation. These plaintiffs only seek coverage for that alleged conduct. Per the
10 analysis in *Liberty Univ.* and *Catholic Bishop*, those allegations are enough to trigger coverage.

11 Plaintiffs are also entitled to coverage because the complaints adequately alleged
12 “property damage” or “bodily injury,” including through incorporation of the employees’
13 affidavits and express allegations of mold. In addition, the extrinsic evidence plaintiffs provided
14 the insurers prior to this lawsuit and in the briefing include documented instances of covered
15 property damage and bodily injury. For example, the Apex report set forth numerous instances
16 of damage to the military communities. It is conceivable that the allegations of negligent
17 conduct (which constitute an occurrence) resulted in the property damage and/or bodily injury
18 detailed in the complaints and extrinsic evidence.²³ It is also possible that the plaintiffs’ failure
19 to supervise employees or its negligent failure to discover the conduct resulted in further
20 property damage.²⁴ This is exemplified in the damage detailed in the Apex report discussed in

21
22 ²⁰ *Id.* at 531 (citing *Pac. Ins. Co. v. Catholic Bishop of Spokane*, 450 F.Supp.2d 1186 (E.D. Wash. 2006)).

²¹ 450 F.Supp.2d 1186 (E.D. Wash. 2006).

²² *Expedia, Inc. v. Steadfast Ins. Co.*, 180 Wash.2d 793, 802 (2014).

²³ In an effort to avoid redundancy, plaintiffs do not address the issue of property damage or bodily injury in
23 this reply. That issue has been briefed in great detail throughout this case.

²⁴ *See Colony Spec. Ins. Co. v. Mut. of Enumclaw Ins. Co.*, Case No. 15-cv-783-MC, 2016 WL 1271665, at *4-
24 5 (D. Or. Mar. 29, 2016) (holding that continuing damage to property is covered under the policy).

1 plaintiffs' initial motion. The alleged negligence could have resulted in water damage (or other
2 similar progressive and ongoing property damage) that could or should have been repaired but
3 instead remained and spread further.

4 DATED: June 3, 2016

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CERTIFICATE OF SERVICE

I certify that on June 3, 2016, I electronically filed the foregoing MOTION FOR RECONSIDERATION with the Clerk of the Court for the United States District Court for the Western District of Washington by using the CM/ECF system.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

Dated: June 3, 2016

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